STATEMENT BY THE
AMERICAN ASSOCIATION OF RETIRED PERSONS
BEFORE THE
SPECIAL COMMITTEE ON AGING
OF THE UNITED STATES SENATE
ON
THE GOALS OF SOCIAL SECURITY
FEBRUARY 10, 1998
WITNESS: Joe Perkins

AARP appreciates the opportunity to present its views regarding the goals for our Social Security system. Americans of all ages have a stake in ensuring that this critical family income protection program continues as the stable base on which beneficiaries can build a secure financial future with the addition of individual savings and pensions.

For over 60 years, Social Security has been the base of our nation's family income protection system. The program faces a long-term challenge, but not a crisis. Today, Social Security has a reserve exceeding $600 billion, which is invested in government securities. Since the program will continue taking in more revenue than will be needed to pay benefits and administer the program for many years to come, it will continue to accumulate substantial assets. According to Social Security Administration (SSA) actuaries, the program will have sufficient assets and revenue to continue paying full benefits on time for another 32 years. Although its assets are projected to be depleted in 2029, Social Security's incoming revenue can continue to finance 75 percent of the benefits promised under current law well beyond 2029.

In order to help find a reasonable solution to restore long-term financial stability, the American people and their elected officials should first engage in an inclusive national dialogue about how Social Security operates, its goals, the many options to achieve long-term solvency, and the impact of these options on their families' future. This dialogue can help identify the essential features of a financially-strengthened Social Security program that can continue providing income protection to all beneficiaries, now and in the future.

AARP commends this committee for furthering the dialogue regarding Social Security's future. We hope this hearing underscores the need for a comprehensive discussion that helps lay the foundation for a reasonable solution to Social Security's long-term challenge.

I. SOCIAL SECURITY: AN EVOLVING PROGRAM

Social Security was conceived during the Great Depression when millions of working Americans faced an uncertain economic future and millions of older Americans faced an impoverished retirement, or no retirement at all. Social Security was designed to protect against "the hazards and vicissitudes" that workers might face if they had sole responsibility for their financial security in retirement. It is a near universal, defined benefit program that serves as the income base, to which workers can add an employer provided pension, and their personal savings. Social Security was not intended to be the sole retirement income source, yet today, one in four beneficiaries depend on it for at least 90 percent of their income. This reliance, which is projected to continue in the future, reflects weaknesses in our private pension system and the inability of many individuals to accumulate and preserve significant savings while in the paid labor force. It is critical that we address these areas as well.

Since its inception, Social Security has weathered financing problems and adapted benefits to reflect changing economic and demographic conditions. The system will face its most serious demographic test when the 75 million Boomer generation retires. In 2008, the first Boomers will be eligible for Social Security, and the system should be financially prepared. Adjustments ought to be in place to ensure the continued payment of reasonable benefits to succeeding generations. A timely adjustment before the Boomers retire can and should be made. In fact, other institutions, such as the public school system, responded to the impact of this generation. While the schools had to accommodate the Boomers with little advance notice, Social Security has had a considerably longer lead time to prepare for the Boomers' retirement. We should begin considering changes to Social Security now so this nation's most successful and popular federal program can accommodate this generation and those who follow them.

II. PRINCIPLES THAT SHOULD BE MAINTAINED

Some of the enduring elements of a Social Security system already have been identified by the Social Security Advisory Council. In 1995, AARP adopted a set of principles that we believe should be reflected in any solvency plan. (They are attached)

AARP and the Social Security Advisory Council agree on the following goals:

- **Social Security should be self-financed with contributions from workers and employers**.

The Social Security system is financed through an earmarked revenue source, payroll taxes, that is credited to the Social Security trust funds. Payroll tax contributions by employees and employers give both a stake in the program's future. Since Social Security's financing source is distinct and its operations are separate from the rest of the government, the system can be carefully monitored. This scrutiny helps ensure adequately financed benefits and a timely warning of potential problems. Earmarked funding means Social Security does not take away general government revenues needed for other programs, and it prevents Social Security dollars from being used directly for non-Social Security purposes. Moreover, most Americans consider the payroll tax fairer than the income tax.

- **Social Security should be compulsory and universal participation achieved.**

Universal participation is essential in a social insurance program. Under social insurance, workers pool their resources in a government-sponsored insurance plan to protect them against unforeseen circumstances, which as individuals they otherwise might not have purchased, afforded, or received from their employer. Although some people might have sufficient financial resources to purchase the benefits--including survivor, dependent, disability, and retirement protection--a pooling arrangement means all contributors can receive a more secure base of financial protection throughout their lives and far fewer people will face impoverishment.

Universal participation enlarges the pool of money from which to finance benefits, and, therefore, provide more complete protection. For many working Americans, Social Security is the only source of survivor, dependent, and disability benefits. For most beneficiaries, it is the only income source they have which is adjusted annually for inflation. By requiring universal participation, the program can distribute benefits progressively, and low-income workers are provided a more adequate level of financial security. Universal participation also protects those whom private insurers might exclude from their plans. For example, insurers might be reluctant to underwrite a disability benefit for someone with a pre-existing medical condition or a life insurance policy for someone whose older relatives are long-living.

Universal participation is desirable for other reasons as well. It ensures that workers will have continuous protection even if they change jobs. It keeps administrative costs low by eliminating fees traditionally associated with private insurers. Universal participation ensures a sense of community and public purpose and a consistency from one generation to the next. Everyone contributes, everyone receives benefits, and everyone bears a measure of responsibility for their retirement. Since everyone contributes while working, future retirees need not endure the financial uncertainty and hardship earlier generations faced. Because their past contributions as workers qualify them for Social Security, current and future beneficiaries will not have to depend on the financial fortunes of their younger relatives or the empathy of society.

- **Social Security benefits should bear a direct relationship to contributions;**
- **Social Security should continue to protect low-wage earners by paying benefits that keep them from relying on means-tested benefits; and**
- **Social Security benefits should be provided regardless of income.**

These three principles have been largely responsible for the enormous and consistent support Social Security enjoys among Americans of all ages. The Social Security benefit formula blends the concepts of "individual equity" (a direct relationship between contributions and benefits) and "social adequacy" (providing an income floor to all who qualify for benefits). To preserve the concept of equity, benefits reflect an individual's work history and payroll tax contributions. Thus, average and higher earners will receive a higher benefit because they contributed more. To provide adequacy, however, the formula is weighted so lower-wage workers receive a benefit that replaces a higher percentage of their pre-retirement wages than for average- or high-wage earners. This weighting helps protect lower-income workers and their families from destitution when a wage earner leaves the workforce, and provides all beneficiaries with a measure of dignity and independence. The progressive benefit formula is critical because lower-wage workers generally do not accumulate sufficient financial resources, such as a private pension or savings, that help replace their lost wages. In a sense, the blending of adequacy and equity acknowledges that Social Security is not designed as an investment program, but rather as basic income insurance against economic hardship and unforeseen events. If equity were the only consideration, the highest contributors would receive a larger benefit and those with smaller overall contributions would have less adequate income protection.

Social Security benefits are based on contributions made over a working life and are provided to all who qualify. If benefits were conditioned solely upon need, i.e., means tested, public support would drop precipitously. If there is any doubt about this, one need only compare the level of public support for programs that serve those with low incomes to the support for universal programs like Social Security. Denying benefits to high-income workers would make them far less willing to participate in the program. The Social Security benefit formula, which represents an implicit income transfer from high to low earners, would be undermined if high earners opted out of a system that might deny them benefits. Moreover, means testing sends the wrong signal about savings. By curtailing benefits when they retire, savers, in effect, are penalized for their thriftiness and farsightedness.

111. BENEFITS THAT SHOULD BE PROTECTED

Social Security includes an array of benefits and income protections that should be maintained in a future solvency package. These include :

- **Social Security benefits for the spouses and children of retired and deceased workers; and**

- **Social Security benefits for disabled workers and their families.**

The availability of these benefits further demonstrates that Social Security has a broader purpose beyond that of an individual investment. By extending financial protection to the families of retired and deceased workers and to disabled workers and their families, the program protects a broad spectrum of society against risks that cannot be anticipated, particularly at the beginning of a working life. Spousal benefits make a considerable difference in the economic well being of widows, young and old, and for divorced spouses, who otherwise might find themselves in or close to poverty. While the percentage of married women workers is higher now than when the program began, women's wages tend to be lower than their male counterparts. Consequently, many women will receive a retirement benefit that blends their own benefit with one earned for them by their spouse.

Disability benefits were added to Social Security in the 1950s. Younger workers tend to overlook and undervalue these disability and survivor benefits (equivalent to life insurance). Yet, Social Security is the only long-term disability insurance for 3 out of 4 workers, and its life insurance features provide income protection for 98 percent of the children in this country. According to the Social Security Administration, the Social Security survivor benefit is equivalent to about $300,000 in life insurance for the spouse and two children of a deceased worker with an average earnings history, and disability protection equivalent to a policy worth over $200,000. If survivor and disability benefits were based solely on a worker's contributions, young workers and/or their families might not receive extended benefits because they would have "used up" their contributions.

- **Social Security benefits are adjusted annually for inflation once they begin.**

Among the provisions which the Social Security Advisory Council reaffirmed is automatic cost-of-living adjustments (COLAs). COLAs are critical to most beneficiaries' income security. These adjustments provide beneficiaries with an income source that helps keep pace with rising prices even if they have insufficient additional resources. Today, Social Security is the dominant income source for 3 of 5 beneficiaries and virtually the only income source for I in 4 beneficiaries, most of them single older women. Given this widespread reliance on Social Security, any reduction in COLAs would mean that millions of beneficiaries would face economic hardship. In fact, most of the dramatic reduction in the poverty rate for those age 65 and over in the early 1970s was due to the large ad hoc increases in Social Security that preceded automatic cost-of-living adjustments. Since then, the poverty rate for the elderly has stabilized because annual COLAs have prevented the more than one in five older Americans -- mostly older single women -- who are below 125 percent of the poverty line from falling further behind economically.

COLAs help ensure that beneficiaries, particularly the oldest ones, will not outlive their resources. If COLAs were eliminated or permanently reduced, the real value of Social Security would decline as beneficiaries become older. In effect, beneficiaries would be poorer at age 80 than at age 65. This is particularly true given that their other income and assets have likely declined and their health care costs have risen sharply.

IV. OTHER CONSIDERATIONS

A. Overall Retirement Income

While it is important to consider specific Social Security goals, decisions about the program should be viewed within the broader context of overall income security in retirement. Retirement income often has been compared to a three-legged stool comprising Social Security, pensions and private savings. Multiple retirement income sources can improve economic security by distributing financial risk among the government (Social Security), the employer (pensions), and the individual (savings). Today, Social Security is the strongest of the three legs. A majority of current beneficiaries depend on Social Security for the largest share of their income, and one in four have little or no other income.

Pensions are retirement benefits earned in employer-sponsored plans. Today, only half of all workers are covered by any type of pension plan. Highly compensated individuals are more likely to be covered by or participate in pension plans and generally accrue higher benefits. Some pension plans ("defined benefit"), like Social Security, promise a specific benefit level based on earnings and time in the labor force. The benefits provided by other types of pensions ("defined contribution") reflect the value of the worker's account when he/she retires. Over the past 15 years, there has been a dramatic increase in individual account plans, such as 401 (k)s, in which the responsibility to save, as well as the risk of poor investment performance, rest with the employee. Given this ongoing shift in the private sector, it becomes even more important to maintain Social Security's shared risk design and defined benefit promise.

Savings represent individually held assets and investments. High earners are most likely to accumulate savings and in far greater amounts than low-wage workers. Many households, however, have little or no retirement savings, and those with savings all too often need to or choose to expend them for non-retirement purposes. Currently, three quarters of all lump-sum payouts are not rolled over into another retirement vehicle. Given the low level of individual savings, it seems probable that many future retirees will have inadequate savings to meet their income needs.

Since pensions and savings continue to be modest or non-existent for many households, Social Security is likely to continue as a dominant income source. In order to ensure retirement income adequacy, policy makers will have to improve all three legs. As legislators consider options for all three legs, they should acknowledge the different role each leg plays. Future policy should build upon the opportunities for individual responsibility and control that already exist in the pension and savings legs -- areas more appropriate for individual risk and responsibility. The Social Security leg, however, should continue its role as the guaranteed base of income.

B. Work Force Participation

The shape of the Social Security program influences the labor market and older workers' labor force participation rates. It is legitimate to question whether Social Security should be neutral with regard to decisions about continued participation in the labor force or whether it should affect the decision. Currently a worker can collect reduced benefits at age 62, the Early Eligibility Age. These benefits are actuarially reduced to reflect receipt prior to the Normal Retirement Age. The age at which workers apply for Social Security has dropped by about three years since the 1960s. For some workers, access to Social Security at age 62 enables them to voluntarily leave the labor force and spend a longer period of time in retirement. Others do not retire voluntarily but leave because of ill health, a physically demanding job, or unemployment. Some ostensibly retire voluntarily but do so in the face of possible employment termination. As policy makers consider an increase in the Normal Retirement Age and/or the Early Eligibility Age, they should determine whether the labor market will generate sufficient jobs for older workers who are able to work, and whether there are adequate income protections within or outside of Social Security for those who become disabled or unemployed before attaining the age of eligibility for Social Security.

C. Employers

Decisions about Social Security will affect employers costs independent of a change in their share of the payroll tax. If older workers delay retirement in response to an increase in the age for initial or full Social Security benefits, employers could incur added pension and employee benefit costs. For example, employers who provide "bridge payments" to workers who take early retirement until they become eligible for Social Security might have added costs. If Social Security benefits are scaled back, employers, many of whom "integrate" their pensions with Social Security, might well face added pension costs. Indeed, some workers might pressure employers to improve their pension benefits because a smaller Social Security benefit diminishes their overall retirement income.

V. CONCLUSION

Americans of all ages should become better informed about the Social Security system so they can participate in the debate about its place in their future. The program has been, and should continue to be, an important part of our nation's commitment to providing income protection for workers and their families against the financial difficulties many otherwise would endure as a result of retirement, death or disability.

Maintaining Social Security's long-term solvency and improving the overall retirement income of future generations is vital to our nation's economic well-being. Fortunately, the over $600 billion now in the Social Security trust funds will increase dramatically over the next decade. Thus, we have time to conduct a meaningful national dialogue that will lead toward informed judgment and consensus about the best way to strengthen the program for the long term.

The Association looks forward to participating on a bipartisan basis with our nation's elected officials to achieve a solution to Social Security's long-term problems. This solution should maintain the program's guiding social insurance principles, ensure benefit adequacy, and achieve solvency in a fair and timely manner. Social Security must continue its role as the foundation of lifetime income security for tomorrow's beneficiaries.

PRINCIPLES FOR SOCIAL SECURITY REFORM

Any Social Security solvency package must:

1. maintain the earned-right nature of the benefit (beneficiaries earn the right to a benefit by working a minimum of ten years in Social Security covered employment);

2. maintain the link between a worker's pay and time in the labor force and that worker's benefit;

3. maintain a progressive benefit formula that provides a higher replacement rate for low-income earners;

4. provide a benefit to all who have contributed to the system and meet the qualifications for a benefit (no means-testing i.e. no conditioning of eligibility on individual income or assets);

5. maintain the self-financed nature of the system;

6. require contributions from both employers and employees;

7. require participation from all workers-this means newly hired state and local workers; this would not be retroactive (provide an opportunity for those workers still in non-covered employment to participate as self-employed Social Security-covered workers for the remainder of their lives in non-covered employment);

8. continue full and automatic adjustments of benefits for changes in the cost of living;

9. continue to provide disability protection;

10. continue to provide protection for families of workers through dependent and survivor benefits;

11. maintain early retirement benefits that, while reduced, are the actuarial equivalent of the amount received at full retirement age.

AARP believes all who participate in the system (beneficiaries, employers, and employees) should share the sacrifice that will be required to achieve long-term solvency.